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Richard Juhnke
General Attorney
Federal Regulatory Affairs

EX PARTE OR LATE FILED

1850 M Street, NW, 11th Floor
Washington, D.C. 20036
Telephone: (202) 828-7437
Fax: (202) 857-1792
E-mail: richard.juhnke
@mail.sprint.com

EX PARTE PRESENTATION

November 5, 1998

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: CC Docket No. 96-128

Dear Ms. Salas:

Attached for inclusion in the record in the referenced proceeding is a copy of the transcript of the oral argument before the U.S. Court of Appeals for the District of Columbia Circuit in MCI Telecommunications Corporation v. FCC, No. 97-1675, held on May 7, 1998. A copy of the cover page and pp. 25-26, 31-33, and 38-42 are being furnished to Kyle Dixon of Commissioner Powell's office.

An original and one copy of this letter are being filed.

Sincerely,



Attachment

c: Kyle Dixon (w/pages referenced above attached)

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TRANSCRIPT OF PROCEEDINGS

**IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT**

MCI TELECOMMUNICATIONS CORPORATION,
Petitioner,

No. 97-1675,
Et al.

v.

**FEDERAL COMMUNICATIONS COMMISSION
AND UNITED STATES OF AMERICA,**
Respondents.

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

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=====X
:
MCI TELECOMMUNICATIONS CORPORATION, :
:
: Petitioner, :
:
: No. 97-1675,
: et al.
:
v. :
:
FEDERAL COMMUNICATIONS COMMISSION :
AND UNITED STATES OF AMERICA, :
:
: Respondent. :
:
=====X

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Thursday,
May 7, 1998

Washington, D.C.

The above-entitled matter came on for oral
argument, pursuant to notice:

BEFORE:

THE HONORABLE HARRY T. EDWARDS, Chief Judge
THE HONORABLE LAURENCE H. SILBERMAN, Judge
THE HONORABLE JUDITH W. ROGERS, Judge

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APPEARANCES:On Behalf of the Petitioners MCI, et al.:

JOHN B. MORRIS, JR., ESQ.
Jenner & Block
601 13th Street, N.W.
Washington, D.C. 20005

On Behalf of the Petitioners III Public Telecom.
Assn.:

ALBERT H. KRAMER, ESQ.

On Behalf of Respondents:

KENNETH DOROSHOW, ESQ.
Federal Communications Commission
Washington, D.C. 20554

On Behalf of Intervenors:

MICHAEL KELLOGG, ESQ.

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C-O-N-T-E-N-T-S

ORAL ARGUMENT OF:

John B. Morris, Esq., on behalf of Petitioners MCI	4
Albert H. Kramer, Esq., on behalf of Petitioners, Illinois Public Telecommunications Association	15
Kenneth Doroshow, Esq. on behalf of Respondents	24
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P-R-O-C-E-E-D-I-N-G-S

1 THE CLERK: Case No. 97-1675, et al.

2 MCI TELECOMMUNICATIONS CORPORATION

3 v.

4 FEDERAL COMMUNICATIONS COMMISSION

5 AND UNITED STATES OF AMERICA

6 Mr. Morris for Petitioners MCI, et al.,

7 Mr. Kramer for Petitioners Illinois Public

8 Telecommunications Association, Mr. Doroshov for

9 Respondents, and Mr. Kellogg for Intervenor.

10 MR. MORRIS: Good morning, Your Honor.

11 THE COURT: Mr. Morris, this case is under
12 reconsideration before the Commission. Why should we
13 be hearing it at this point?

14 ORAL ARGUMENT OF JOHN B. MORRIS, ESQ.

15 ON BEHALF OF PETITIONERS MCI

16 Your Honor, it's -- would it be
17 appropriate for this Court to defer to the FCC's
18 reconsideration if the FCC were here before the Court,
19 essentially admitting the errors that Petitioners here
20 have raised. But the FCC is doing that. The FCC is
21 vigorously defending --

22 THE COURT: Wait, wait, wait, that's not
23 responsive to a question of ripeness.

24 MR. MORRIS: Well, in terms of judicial

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1 efficiency and judicial economy, and the FCC, we will
2 certainly be in a Payphone IV for if the FCC goes
3 through with its reconsideration and continues to
4 promulgate its scheme as it has done --

5 THE COURT: Well, but then the Court would
6 only look at it once. We don't want to keep looking
7 at this thing over and over again. If someone is
8 seeking reconsideration on the precise issue before
9 us, then the FCC is going to do whatever it's going to
10 do whether it's more of the same or less of the same
11 or whatever. We don't want to take it time after time
12 after time and judicial prudence warrants that we wait
13 until the Agency is done.

14 Why is that wrong?

15 MR. MORRIS: Well, the FCC's errors here
16 are so fundamental --

17 THE COURT: That's doesn't --

18 THE COURT: You mean your constitutional
19 should take over the FCC?

20 THE COURT: That's not an answer. Come
21 on. I mean all of you who are going to get up today
22 have to do better than that. That's not an answer in
23 normal prudential jurisprudence when we're talking
24 about questions of ripeness. If the matter is still
25 before the Agency, it's a large issue, we don't want

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1 to take it several times. I mean that's the whole
2 point of reconsideration. If the errors are as
3 glaring as you suggest, then maybe they'll notice it.

4 MR. MORRIS: Well, except it is crystal
5 clear we have a situation as in the Food Marketing
6 Institute v. ICC, where the Agency has grasped on to
7 a scheme and is --

8 THE COURT: But reconsideration may
9 mitigate whatever problems you perceive. That's my
10 question. Let's assume that what they've done is
11 written an opinion that says what follows is patently
12 stupid and then indeed it is indeed patently stupid,
13 that's still not an answer to say that they've said
14 something is patently stupid, if it's under
15 consideration, reconsideration. Why in heaven's name
16 would we waste time struggling with this issue? It's
17 like us weighing in on the whole reconsideration
18 process and that's not our role. Our role is to judge
19 what they do.

20 MR. MORRIS: The FCC's reconsideration
21 process is focused on the scheme that it's adopted.
22 That scheme fundamentally is flawed.

23 THE COURT: So your basic point is that
24 starting at 35 cents is fundamentally wrong and the
25 reconsideration goes to all of the offsets off that,

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1 right?

2 MR. MORRIS: Everything the FCC --

3 THE COURT: Is brought. Suppose they came
4 up with so many different offsets that they dropped it
5 down to 10 cents. You'd be delighted.

6 MR. MORRIS: You're absolutely right.

7 THE COURT: You wouldn't be back.
8 Frankly, even if they're stupid, if they come out with
9 a nice result, you'd love it.

10 So --

11 THE COURT: In other words, even if the
12 foundation was absurd, the 35 cent foundation was
13 absurd, you were right on that. You came out with a
14 number that was so low you --

15 THE COURT: You'd still be coming back
16 saying we want to go even lower because the foundation
17 is wrong and well, probably not.

18 MR. MORRIS: In this case where even a
19 single penny of error translates to \$30 million.

20 THE COURT: No, we understand the point.
21 We understand the point, but as Chief Judge says, this
22 is like a moving target for us.

23 MR. MORRIS: Unavoidably, the fundamental
24 foundation of the FCC's order will be before the Court
25 because even if the FCC goes way the other way --

1 THE COURT: I mean you can go back and say
2 don't be afraid to reconsider the fundamental premise
3 too.

4 THE COURT: Have you sought
5 reconsideration too? You haven't?

6 MR. MORRIS: Excuse me?

7 THE COURT: Have you sought
8 reconsideration as well?

9 MR. MORRIS: No.

10 THE COURT: But everybody else has sought
11 reconsideration. So it's sort of a strange situation,
12 isn't it? All the Intervenors have sought
13 reconsideration, including AT&T, who is the same
14 position you're in. Your interests are exactly the
15 same as best I can tell.

16 MR. MORRIS: That is correct. In this
17 case, however, Your Honor, and what the FCC has done,
18 we would submit, to boldly and baldly ignore this
19 Court's directions in the Payphone I case.

20 THE COURT: They've done that before.

21 (Laughter.)

22 THE COURT: It's surely not a novelty.
23 Judge Silberman took the words out of my mouth.

24 THE COURT: It's not a first.

25 MR. MORRIS: It may not be the first time,

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1 but I would submit that it would be appropriate for
2 this Court to at this point of the juncture correct
3 the FCC and say no FCC, you apparently did not
4 understand Payphone I, do it right so that the next
5 time it comes up to us it does reflect what --

6 THE COURT: What's the status quo,
7 counsel?

8 MR. MORRIS: Excuse me?

9 THE COURT: What's the status quo?

10 MR. MORRIS: I'm sorry?

11 THE COURT: Money status quo. Who is
12 paying what?

13 MR. MORRIS: Right now, IXC and ultimately
14 800 subscribers --

15 THE COURT: How much are you weighing?

16 MR. MORRIS: 28.4 cents.

17 THE COURT: You're paying the rate that
18 came out of this ruling?

19 MR. MORRIS: Well, the actual payments
20 have been, it's a 6-month lag, so I frankly don't --
21 I can't tell the Court whether payments have been made
22 today, but right around April or May or this year is
23 when the actual payments will actually start being
24 made.

25 THE COURT: All right, and what was it

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1 before that? You were paying nothing?

2 MR. MORRIS: Well, before that we were
3 paying approximately \$6 per phone charge.

4 THE COURT: Which roughly amounted to how
5 much, if you convert to the per call?

6 MR. MORRIS: Less than 28.4 cents.

7 THE COURT: So in April or May you'll have
8 to go up to 28.4?

9 MR. MORRIS: Right, starting back in
10 October of last year, the payments are to be made in
11 this time period.

12 THE COURT: Well, I don't mean to suggest
13 how counsel might proceed, but if we were considering
14 holding or sending this back in light of
15 reconsideration, there's certainly a reasonable
16 argument to be made in that you've filed a motion to
17 the effect that the rates shouldn't go into effect
18 while the reconsideration is going on.

19 MR. MORRIS: Absolutely and we --

20 THE COURT: You hadn't said that in your
21 brief. I mean that might be underlying what -- maybe
22 what your underlying concern is.

23 MR. MORRIS: Well, the Petitioners did
24 file a motion for stay with this Court which this
25 Court did deny. If a stay of the order had been

1 entered, we would be more than happy, I'd be happy to
2 sit down right now. If this Court would --

3 THE COURT: What was the -- I don't
4 remember -- how did we deny? Did we deny it deferring
5 to the merits or just denied it?

6 MR. MORRIS: I'm afraid -- it was a very,
7 very short and simple denied.

8 THE COURT: Well, then it should be easy
9 for you to remember it.

10 MR. MORRIS: I'm trying to remember if
11 there was a subtle nuance within the order denying it.
12 I think it was simply a --

13 THE COURT: The subtle nuances only come
14 from the FCC, never from us.

15 (Laughter.)

16 MR. MORRIS: But absolutely, if this Court
17 would direct the FCC to stay the order and in fact, I
18 would certainly suggest that the --

19 THE COURT: You did, in fact, make that
20 motion?

21 MR. MORRIS: We absolutely made the
22 motion.

23 THE COURT: What were the grounds for your
24 motion?

25 MR. MORRIS: The grounds for the motion

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1 were very, very similar to the grounds that we're
2 presenting now, almost identical, really, very
3 parallel. Most --

4 THE COURT: Did you bring it to the
5 Court's attention that these matters were under
6 reconsideration before the Agency?

7 MR. MORRIS: The Court was aware of that
8 during the briefing.

9 THE COURT: Did you bring to the Court's
10 attention as part of your motion for stay that these
11 matters, much of the rule was still under
12 reconsideration before the Agency?

13 MR. MORRIS: I honestly can't tell you if
14 our motion papers mentioned that. I assume it did.
15 We certainly gave a status --

16 THE COURT: Well, if your argument was
17 you're going to win for sure, therefore you should get
18 a stay, in a complex case, that's hard to prevail, but
19 if you told the Court that there was this
20 reconsideration going on in the meantime that would
21 have added to the strength of your motion to stay --

22 THE COURT: Well, our order said you
23 simply didn't grant, you simply didn't meet the
24 standard. Now if you didn't -- if it said you didn't
25 meet the standard, the normal standard for a stay.

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1 Now if you didn't include this, that may have been
2 part of the reason.

3 MR. MORRIS: Well, I believe that we did
4 make clear that the order was under reconsideration at
5 the FCC.

6 THE COURT: In the motion for a stay?

7 MR. MORRIS: I believe we did, and I don't
8 have the papers in front of me and I don't want to --

9 THE COURT: But your position now is that
10 everything you've raised here is pending before the
11 FCC as well, now?

12 MR. MORRIS: I believe that most of the
13 issues I can't say every single --

14 THE COURT: Is there anything that is not
15 before the FCC? Or is there anything to bar the FCC
16 from considering all the issues that you've raised
17 here?

18 MR. MORRIS: No, there's nothing that
19 would bar the FCC from considering all the issues.
20 But the FCC has made very plainly clear that it is
21 very dubious of the possibility that if it lowers the
22 compensation rate that it would order a retroactive
23 adjustment --

24 THE COURT: I was going to ask you about
25 that.

1 MR. MORRIS: Excuse me?

2 THE COURT: I was going to ask you about
3 that.

4 MR. MORRIS: So our clients right now are
5 supposedly, apparently, liable for 28.4 cents with no
6 clear prospect --

7 THE COURT: But if we granted you a stay,
8 that would tend to concentrate the mind of the FCC and
9 rather get a pretty quick action from them on
10 reconsideration.

11 MR. MORRIS: Absolutely. If we had a stay
12 and certainly --

13 THE COURT: It would certainly also
14 concentrate the mind of the RBOCs, too.

15 MR. MORRIS: I think it would and as the
16 FCC did in Payphone II, in the second Report and
17 Order, it moved very, very quickly. We would even
18 suggest too hastily to readopt its scheme --

19 THE COURT: When did this rate go into
20 effect?

21 MR. MORRIS: Excuse me?

22 THE COURT: When did this rate go into
23 effect?

24 MR. MORRIS: October of 1997.

25 THE COURT: No, no, I thought you said it

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1 didn't go into effect until April or --

2 MR. MORRIS: I'm sorry, the rate went into
3 effect. The rate is in effect today. It was in
4 effect on October of 1997. The process for payments
5 take about six months long and so actually --

6 THE COURT: So you presumably are liable
7 for that amount, but it hasn't been paid?

8 MR. MORRIS: I don't know if --

9 THE COURT: So if you got a stay, that
10 could just be hell, that check not be sent out.
11 That's the way you're thinking. Okay.

12 MR. MORRIS: Absolutely. Now I see that
13 my time has run out.

14 THE COURT: It has. Yes, I agree, it's
15 run out.

16 (Laughter.)

17 THE COURT: If we need to talk with you
18 more about the merits, we will.

19 MR. MORRIS: That's fine. Thanks very
20 much.

21 ORAL ARGUMENT OF ALBERT H. KRAMER, ESQ.

22 ON BEHALF OF PETITIONERS, ILLINOIS PUBLIC

23 TELECOMMUNICATIONS ASSOCIATION

24 I'm Albert H. Kramer. I represent the
25 payphone parties and intervenors in this case. These

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1 providers are all independent payphone providers.
2 They are not RBOCs.

3 THE COURT: Same question, counselor.

4 MR. KRAMER: Your Honor, the information
5 that there was reconsideration pending was before the
6 Court at the time the Court ruled. The FCC had raised
7 it in its opposing papers.

8 We did not oppose deferring the briefing
9 on this case until reconsideration occurred.

10 THE COURT: So you wouldn't oppose our
11 sending it back now?

12 MR. KRAMER: We would not.

13 THE COURT: I only have one question, was
14 one of us on the Panel?

15 THE COURT: Yes, Judge Rogers.

16 THE COURT: Oh, gosh. I was about to say
17 if I was on the Panel we're certainly capable of
18 recognizing that typically when an issue comes up on
19 motions and even if we deny it, we tend to think that
20 we can look at it again on merits.

21 MR. KRAMER: Your Honor, I would agree,
22 you certainly can do that. We did oppose a stay. We
23 are concerned while, Judge Silberman, you mentioned
24 the RBOCs. There is an independents part of this
25 industry that is far more fragile and in light of the

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1 fact that the Court vacated the order last time, there
2 is very, very little compensation and the cash flow
3 crisis is desperate for the independent industry. So
4 to the extent --

5 THE COURT: Desperate -- you weren't
6 getting enough in the past, the \$6?

7 MR. KRAMER: Your Honor, we were getting
8 the \$6. That amount to about 4 cents per call based
9 on the record.

10 THE COURT: You mean this is a big jump
11 from 4 cents to 28 cents? So this is an enormous
12 difference, right?

13 MR. KRAMER: There is an enormous
14 difference, but --

15 THE COURT: That's the effective
16 difference, 4 cents to 28?

17 MR. KRAMER: That's the effective
18 difference, Your Honor.

19 THE COURT: There's no cash flow now
20 anyway because you haven't had any money paid out on
21 the new rate.

22 MR. KRAMER: The cash is beginning to flow
23 right now as we speak. The checks are beginning to
24 come from the carriers, but you have to understand
25 that while that's an enormous increase, at the same

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1 time there has been a concomitant fall in the volume
2 of cash because that dial around traffic is taking
3 away all the cash generating traffic, the zero plus
4 traffic that normally generates the cash. So you have
5 seen a fall --

6 THE COURT: I don't understand that. You
7 mean just because dial around is expanding?

8 MR. KRAMER: Yes, Your Honor.

9 THE COURT: Because of what? Why is dial
10 around expanding?

11 MR. KRAMER: The typical caller used to
12 walk up to a payphone and dial 0+ and then the number
13 and so forth. That call is a commissionable call for
14 the payphone provider. What has happened is traffic
15 has been driven away from the 0+ and into the dial
16 around calls and so you've had cash flow falling
17 because of the decline in the --

18 THE COURT: Why has it been driven away
19 from the 0+?

20 MR. KRAMER: Because callers are using the
21 dial around instead of the 0+.

22 THE COURT: Why are callers using the dial
23 around?

24 MR. KRAMER: In part, because of a massive
25 advertising campaigns by the carriers. If you watch

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1 TV, if you read magazines --

2 THE COURT: Because you don't know whose
3 system you're using, so you've got to use their dial
4 around.

5 MR. KRAMER: Well, that's right. And
6 that's fine.

7 THE COURT: You don't know which carrier
8 has got this call, so yes, to protect yourself because
9 you don't know what you're doing, you want to stay
10 with your own carrier so you use the dial around.

11 MR. KRAMER: That's correct. That's
12 correct. And we did not oppose the FCC's requirement
13 that calls be unblocked for that reason. We believe
14 callers should have a choice, but at the same time as
15 the carriers drive callers to exercise that choice it
16 does drive down the cash flow. So we're very
17 concerned about having, about the stay issue pending
18 the reconsideration because we're in this caste
19 situation. We're not the RBOCs. We don't have parent
20 companies who can keep us afloat, so we're seeing a
21 fall in the cash flow as calls move from 0+ and at the
22 same time nothing happening on the dial around side.

23 That was part of the reason for the law.
24 The law says that payphone compensations were supposed
25 to be compensated effective nine months after the Act.

1 We're now over two years after the Act. This Court
2 has vacated the earlier order. We now have talk of
3 stay of this order. No cash is flowing.

4 Congress would not have put the nine month
5 deadline on if they intended for this to go for
6 payphone providers, and particularly, the independent
7 sector.

8 THE COURT: Yes, but suppose we're quite
9 dubious at the FCC's reasoning with respect with the
10 35 cent double proxy. Wouldn't that contribute to our
11 willingly to grant a stay here and shouldn't it have
12 contributed?

13 Now, of course, you're defending that
14 proxy.

15 MR. KRAMER: Your Honor, it should
16 contribute, if indeed you are dubious. The FCC and
17 Mr. Kellogg will address the merits of that.

18 What I would say is this, while obviously
19 you have to consider that, you also have to consider
20 the fact that you had a statutory mandate. A
21 statutory mandate was that compensation should be
22 paid.

23 What I would urge you --

24 THE COURT: On some reasonable grounds.

25 MR. KRAMER: Pardon me?

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1 THE COURT: On some reasonable grounds.

2 MR. KRAMER: On some reasonable grounds.
3 What I would urge --

4 THE COURT: If they haven't done it,
5 that's not our fault.

6 MR. KRAMER: I understand that, Your
7 Honor. What I would urge the Court to do is if the
8 Court is inclined to grant the stay to -- in this case
9 recognizing the arguments regarding reconsideration,
10 to in fact consider the case because of the
11 extraordinary circumstance that we find ourselves in
12 and the statutory mandate to, in fact, consider this
13 case and give the Commission the guidance it needs
14 now.

15 THE COURT: In other words, if we're
16 dubious make it very clear to the Commission that
17 we're dubious because otherwise you're going to face
18 a long delay if they rely on the same premise and come
19 back up again and we knock it out then, then you're
20 facing another year or two is what you're saying?

21 MR. KRAMER: Then we're facing another
22 year or two without any cash.

23 THE COURT: So if we've got some great
24 concerns, you want us to say we've got some great
25 concerns?

1 MR. KRAMER: Exactly, Your Honor. And
2 what I would urge you to do, in fact, is to please
3 consider the other issues on the merits as well.

4 THE COURT: You mean the ones all under
5 the specific reconsideration?

6 MR. KRAMER: I'm sorry, Your Honor?

7 THE COURT: All the ones, the add ons or
8 the off sets under specific reconsideration?

9 MR. KRAMER: Yes, Your Honor.

10 THE COURT: That's awful hard for us to
11 do.

12 MR. KRAMER: I know that, Your Honor, but
13 they're very important because even if you tell the
14 FCC you have grave doubts, the Agency needs guidance
15 --

16 THE COURT: Arguably, the issue that is
17 most ripe before us is the 35 cent figure because
18 nobody is specifically seeking reconsideration on that
19 although it's implicated in everything.

20 MR. KRAMER: That's correct.

21 THE COURT: But if we're dubious about
22 that, and all the other things are in play --

23 THE COURT: And ar connected to that.

24 THE COURT: And are connected to that, I
25 don't understand why we should even express a view on

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1 all the other questions, although there is one issue
2 that puzzles me that I would be prepared to ask the
3 FCC about and maybe you would and that's the targeting
4 question.

5 One of the premises of the FCC's rule was
6 that the technology of targeting or blocking, targeted
7 blocking could come in and -- but I understand from
8 the briefs that the FCC Bureau has gone the other way
9 on that. So I'm having a heck of a time trying to
10 figure out what's going on.

11 MR. KRAMER: I believe the FCC is prepared
12 to address that, Your Honor. Our specific points --

13 THE COURT: You don't care about that.

14 MR. KRAMER: Well, we care about it if it
15 concerns the Court, obviously.

16 THE COURT: No, but it doesn't directly
17 concern you.

18 MR. KRAMER: It does not directly concern
19 us. We do not believe --

20 THE COURT: We don't worry about targeted
21 blocking.

22 MR. KRAMER: We don't worry about targeted
23 blocking. And we don't believe targeted blocking is
24 a valid concern. As I believe FCC counsel will
25 explain, the FCC set the default rate. The question

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1 before the Court is whether there is a valid rate. If
2 there is a valid rate, targeted blocking cannot --
3 excuse me, if there is not a valid rate, targeted
4 blocking cannot say that, and if there is a valid
5 rate, targeted blocking should not invalidate the
6 rate.

7 The question is, as Judge Edwards
8 indicated, the reasonableness of what the FCC has done
9 and we believe that is the issue that should be before
10 the Court.

11 I would urge, Your Honor, and I do want to
12 reserve some time for rebuttal. I would urge the
13 Court if you again -- I hear what you're saying and I
14 do agree that the most fundamental issue is the need
15 for guidance on these other issues. We would request
16 the Court at least give the Commission some guidance
17 on the logic it followed in making some of the
18 adjustments.

19 I would like to reserve some time for
20 rebuttal, if I may.

21 THE COURT: All right.

22 ORAL ARGUMENT OF KENNETH DOROSHOW, ESQ.

23 ON BEHALF OF RESPONDENTS

24 May it please the Court, my name is
25 Kenneth Doroshow and I represent the FCC. At the

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1 outset, if I may address the concerns that the Court
2 has expressed about the possibility of a stay or at
3 least postponing its decision until after the
4 reconsideration proceeding is completed.

5 There may be some value to waiting for the
6 reconsideration, however, we would vigorously oppose
7 a stay and we opposed the stay when there was a motion
8 before the Court. The purpose of Section 276 is quite
9 clear, to provide compensation to the payphone
10 providers and in considering the balance of harm --

11 THE COURT: Not any compensation.

12 MR. DOROSHOW: Fair compensation.

13 THE COURT: Right.

14 MR. DOROSHOW: And we believe that --

15 THE COURT: Right, but suppose we're of a
16 mind that there's no conceivable way that anyone in
17 their right mind could suggest that the basis here is
18 fair and reasonable?

19 MR. DOROSHOW: I'd be happy to address the
20 elements that --

21 THE COURT: No, I mean suppose that were
22 the case, then what do we do? Suppose we're not
23 convinced. You give us your best shot and we walk
24 away and say it doesn't do it. All of what we first
25 thought is still there. It's nonsense. There's no

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1 reasonable basis. It's not our job to figure out
2 what's reasonable. We leave it in place because you
3 have to have something?

4 MR. DOROSHOW: Well, as between balancing
5 the harm of vacating the rule or staying the rule or
6 not --

7 THE COURT: That's an argument you made
8 last time around on vacating and you lost on that time
9 before the prior Panel which included in the Chief
10 Judge.

11 MR. DOROSHOW: Right. Well, I submit that
12 we will satisfy the Court that the rule is reasonable.

13 THE COURT: Counsel, I'm giving you --
14 you've got to give us a better answer. I'm telling
15 you at least in some of our minds, the grounds are
16 very shaky, shaky enough so that you ought to worry a
17 whole lot about whether or not anyone can be convinced
18 that the grounds stated make any sense.

19 Now if that is the prevailing result, what
20 should we do? Can you really say tenably that we
21 should leave this in place if we can't find a
22 reasonable basis for its existence?

23 MR. DOROSHOW: Your Honor, if, in fact,
24 the Court finds the FCC's approach to be absolutely
25 unreasonable then --

1 THE COURT: Well, but that's going to too
2 far. That's forcing us to rule on the merits.

3 Let me phrase the question this way. On
4 a motion for stay, let's think about this as a motion
5 for stay at this point, we should consider the
6 likelihood of Petitioner prevailing, that's our law.
7 We have to balance the merits on this. And without
8 making a final decision on the issue, if we think that
9 the 35 cents baseline, at least the second step of
10 that thinking process is dubious, is dubious, then
11 that certainly adds to the strength of the motion for
12 stay, doesn't it?

13 MR. DOROSHOW: It certainly adds to the
14 strength of it. However, the other --

15 THE COURT: We should worry about the fact
16 that in the meantime there will be a -- by April there
17 won't be the funds going to the independent -- that's
18 your problem, so you could handle that, couldn't you?

19 MR. DOROSHOW: Well, no, actually, that's
20 a significant problem and I think that's the concern
21 that really should motivate the Court's decision on
22 this --

23 THE COURT: Going to give any refunds?

24 MR. DOROSHOW: Can we give any refunds?
25 I don't think that it's in our power to do that.

1 THE COURT: We've got to weigh that too,
2 don't we?

3 MR. DOROSHOW: Yes, but I think the harm
4 --

5 THE COURT: Are you going to adjust what's
6 finally done if we say that this premise is wrong,
7 makes no sense and you come up with something
8 different and there is a disparity and you're going to
9 adjust the ultimate rate to reflect that disparity so
10 indeed they don't pay what they're now paying if it's
11 the wrong rate?

12 MR. DOROSHOW: The problem with that
13 approach, Your Honor, is in the short run it will be
14 significant harm to the independent payphone providers
15 and the purpose of the statute was to --

16 THE COURT: Well, I mean all you've done
17 is still harm. If our concerns are indeed valid, and
18 we can't find a valid basis, yes, you're talking about
19 harm to one group and another group is asserting harm
20 that they're feeling.

21 MR. DOROSHOW: But Congress has done that
22 shifting for us. Congress has --

23 THE COURT: No, think of this at this
24 point as a motion for stay. When we think about a
25 motion for stay we think of two factors, one, the

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1 merits, who is likely to prevail; and two, the harm.
2 But no case can I remember in the last 12 years that
3 any Panel of this Court deny a stay when it thought
4 that the movant was going to win on the merits or
5 likely was going to win on the merits. In other
6 words, that tends to be your threshold question.

7 So it's very hard to say that recognizing
8 the independent payphone association has a problem,
9 it's very hard to say well, they should get this money
10 even if we're very dubious about the 35 cent proxy.

11 MR. DOROSHOW: I recognize that that is
12 certainly a very significant component of the
13 balancing analysis the Court has to undertake.
14 However, I think that both the significance of the
15 harm to the payphone providers, coupled with the clear
16 congressional mandate here elevates that harm to
17 perhaps a somewhat extraordinary --

18 THE COURT: But you're ignoring Judge
19 Edwards that Congress mandate that you do action, but
20 it doesn't say the Court should uphold illegal action
21 if it comes in within nine months.

22 MR. DOROSHOW: Well, if I may, with the
23 limited time I have --

24 THE COURT: That would be a preclusion of
25 judicial review, wouldn't it?

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1 MR. DOROSHOW: I don't think entirely.
2 But with the limited I have, if I may attempt to
3 persuade the Court that the Commission's approach was,
4 in fact, reasonable.

5 As the Court is aware, in the Payphone I
6 decision this Court upheld as reasonable the 35 cent
7 coin rate for coin calls. What the Court objected to
8 in the Payphone I decision was the FCC's use of that
9 exact same rate in the arena of coinless access code
10 in 800 subscriber calls, noting that there was
11 evidence in the record of some cost differences. And
12 remanded the case to the Agency to account for those
13 differences.

14 THE COURT: And that's the way the Agency
15 interpreted the first opinion, namely, just the cost
16 differential. That was the only problem. And they
17 started at the same point and just deducted.

18 MR. DOROSHOW: Well, no. Actually, the
19 Court looked at the whole matter anew and explained
20 its reasons for why it used the market approach in the
21 first instance. And there are actually two components
22 here. The first question is why did we use the market
23 based approach in the first place and then secondly,
24 why do we use the coin rate as the proxy.

25 THE COURT: And then they said even if we

1 take the cost information it all ends up at the same
2 point anyway.

3 MR. DOROSHOW: That is true. We did do a
4 bottom up cost analysis as a means of checking the
5 validity of the coin rate minus avoided costs.

6 THE COURT: How do you find the market?

7 MR. DOROSHOW: That was the problem. Of
8 course, there is no market for the coinless calls.

9 THE COURT: You didn't start with a
10 market. How do you find one?

11 MR. DOROSHOW: We used the best available
12 surrogate and the coin rate, the coin market surrogate
13 is appropriate because they are virtually the same
14 transactions. They are the -- the cost involved in
15 both sets of calls are almost entirely identical.
16 There are some minor cost differences, as this Court
17 pointed out, but the vast majority of costs are the
18 same. It's the same seller in both instances. It's
19 the payphone provider. It's the same handset, the
20 same cradle, the same box, the same keypad, etcetera.
21 So it's an appropriate proxy for the market rate of
22 coinless calls. And what we have done, consistent
23 with this Court's instructions is address those
24 particular cost differences and subtracted them. So
25 we started with what the Court viewed as a fair rate

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1 for coin calls and then subtracted the rate, the cost
2 differences for a very similar sort of call and we
3 think ended up therefore with a fair rate for the
4 coinless market.

5 THE COURT: The FCC assumes that the rate
6 and cost converge and I don't, for the life of me, I
7 can't figure that out.

8 MR. DOROSHOW: Well, the market rates do
9 reflect costs, certainly, but it is not exactly the
10 same thing as a cost based approach and the Commission
11 explained quite clearly the reasons why a cost based
12 approach --

13 THE COURT: I mean clearly enough to
14 convince me it looks utterly irrational. That's the
15 only thing that seems clear. I mean I've gone through
16 this thing a hundred times and it makes no sense to
17 me. The assumptions are bizarre. To be very honest,
18 if you want to take a shot at it, go ahead. I'm going
19 to tel you my own views. It makes no sense. Rate and
20 costs converge. You're assuming the coin and coinless
21 markets and incentives are the same. It makes no
22 sense. I'm looking for the record to try to figure
23 this out. I can't figure it out for the life of me.

24 MR. DOROSHOW: Well, when we did our --

25 THE COURT: It's not an interesting

1 fiction. I don't know how you even get where you are.
2 It makes no sense.

3 MR. DOROSHOW: Well, for example, the
4 point that Judge Rogers identified, when we did our
5 bottom up cost analysis as a means of checking the
6 validity of the rate, we arrived at a rate that was
7 quite close to the top down result.

8 THE COURT: Do you know what my reaction
9 to that is? If you thought that that was a viable
10 approach, why didn't you just go with that and stick
11 with that? The other way makes no sense.

12 MR. DOROSHOW: Well, the problem with the
13 cost based approach, Your Honor, is that what you
14 ultimately end up with, the cent amount, reflects on
15 the bare recovery of costs. One of the purposes of
16 Section 276, there are two principal goals, one of
17 them is the widespread deployment of payphones for the
18 benefit of the public. With just recovering your
19 costs --

20 THE COURT: Well, even if your just doing
21 costs, you can always have costs and capital in there
22 too which is your profit, etcetera. I mean if you
23 want to use rate, the standard rate based approach,
24 you can do that and you certainly don't mean to
25 suggest that under the standard rate base method of

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1 setting rates that one doesn't think of cost and
2 capital.

3 MR. DOROSHOW: This is true. However, if
4 you ultimately end up with just a cost, a fixed
5 average cost result, there are actually two problems
6 with that in light of the purposes of the statute.
7 First of all, there will not be widespread deployment
8 of payphones because you will have this fixed average
9 cost and therefore higher cost payphones, payphones in
10 high cost locations, simply won't be deployed. The
11 virtues of a market base rate --

12 THE COURT: What do you say to
13 Petitioners' response to that? They said that's silly
14 in their reply brief and they gave me the reasons why
15 they thought that was --

16 MR. DOROSHOW: We actually think our
17 position is quite reasonable. In fact, it's somewhat
18 common sense that if there is a fixed rate of
19 recovery, an average cost, that no one is going to to
20 -- there's no incentive to deploy a higher cost phone.
21 In this deregulated world in which we find ourselves,
22 there's no requirement that a payphone implement a
23 high cost phone and lose money and the rational
24 payphone provider won't do that.

25 THE COURT: Well, actually, the analogy

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1 challenged me on that. If I deployed a number of high
2 cost phones, I'd raise the average cost, right? So
3 I'd make my low cost phones even more profitable?

4 MR. DOROSHOW: True, but that's also --
5 then you have intention with the other purpose of the
6 statute which is --

7 THE COURT: Wait a minute. You were just
8 asking about my incentives and you challenged me and
9 I gave you an answer which is hey, I'll put up a lot
10 of high cost phones because that will raise my average
11 costs and that which I'll get compensated for and I'll
12 get even more profit on the low cost.

13 MR. DOROSHOW: Well, I don't think that
14 you would have the power to do that.

15 THE COURT: Wait a minute, don't you know
16 that it's one of the standard problems in rate based
17 tariff setting that the utilities try to add to their
18 costs, so as to get greater recovery?

19 MR. DOROSHOW: I'm not familiar with that
20 approach, Your Honor.

21 THE COURT: In any event, maybe the
22 problem is the FCC is not familiar with this. I'm not
23 sure you're right about that. I'm not quite as -- I
24 mean I see a little bit more of a potential argument
25 than my colleague does, but I don't -- it sure doesn't

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1 seem to me that the FCC has explained clearly the
2 second step whereby they say -- (a) there's a market
3 rate for coin, which is under attack, but you have a
4 response to that. But the second step that this is
5 the appropriate proxy, the market rate for coin is
6 appropriate proxy for the hypothetical market rate for
7 noncoin is more troubling. There's not much to
8 explain that.

9 MR. DOROSHOW: Well, actually there is
10 quite a bit to explain.

11 THE COURT: In the opinion?

12 MR. DOROSHOW: Yes.

13 THE COURT: Which is?

14 MR. DOROSHOW: Which is that the costs of
15 both -- involving both sets of costs --

16 THE COURT: Well, now you're mixing costs
17 and market rate.

18 THE COURT: That's exactly right, that's
19 what they do. Rate and market converge. You see,
20 Judge Silberman says he's not quite as dubious as me
21 except he goes right to the point that makes no sense
22 to me. That assumption that you raise is --

23 THE COURT: When I say I'm not quite as
24 dubious --

25 (Laughter.)

1 THE COURT: -- I didn't mean to suggest I
2 wasn't dubious.

3 (Laughter.)

4 MR. DOROSHOW: It's more than just a cost
5 analysis here. It's the same transaction essentially.
6 In both instances, you have the handset, the cradle,
7 the keypad, the connection for the local exchange
8 carrier, the podium --

9 THE COURT: But they say that purchaser is
10 totally different.

11 MR. DOROSHOW: I'm sorry?

12 THE COURT: They say that purchaser is
13 totally different.

14 MR. DOROSHOW: Well, that's actually
15 somewhat of a fallacy. The Petitioners make that
16 point. The caller certainly in the coin context the
17 caller is the buyer. In the coinless context, even
18 for access code long distance phone calls, the caller
19 is ultimately the buyer there as well. It's only the
20 subscriber 800 situation where the 800 subscriber is
21 the buyer. But in some sense, it's irrelevant, the
22 extent to which the market differs first of all
23 because the markets are largely similar. And
24 secondly, because the issue here is establishing a
25 fair rate of compensation for the use of this facility.

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1 THE COURT: Why do you say in passing,
2 it's just totally believable because the markets are
3 similar? So what? Your glib, dripping past, that is
4 just what the FCC did and I want you to know there's
5 some other people in the world who we think were
6 somewhat intelligent and look at that and say I don't
7 know what they're talking about. The markets don't
8 look similar. They don't feel similar. You haven't
9 presented anything to convince another intelligent
10 person looking at that they're similar. And that's a
11 critical premise you make.

12 THE COURT: Let me ask you this, all of
13 your arguments suggest that this is not the typical
14 case where the Agency is saying remand this so we can
15 reconsider and go back and address things that the
16 Court is concerned about. The Court in the first
17 opinion told you that it was troubled by the 35 cents
18 and basically in the second order, the FCC just again
19 says this is a proper surrogate, end of discussion,
20 moving on we'll deduct some costs.

21 So isn't the Court or is the Court faced
22 with a situation of I don't mean this in a
23 disrespectful way, but sort of intransigence by the
24 Agency that it's decided this is the way that the
25 scheme should be developed and reconsideration isn't

1 going to change that. There's nothing to indicate
2 anything that the Commission has said, including the
3 Bureau's most recent ruling that the Commission is
4 likely to address the fundamental concern that Chief
5 Judge Edwards and Judge Silberman have been discussing
6 with you this morning. So why should we defer?

7 MR. DOROSHOW: If I may, I actually
8 disagree with the premise of the question which is
9 that we just are -- we were wedded to the market rate
10 without careful analysis. In fact --

11 THE COURT: No, that's not what I said.
12 I said that you're going to start with that 35 cents,
13 all right, and then you're going to make these
14 arguments and tell us that the market is similar and
15 you believe that and the Commission believes it and so
16 there's no point in our staying anything because the
17 Commission is stuck with that.

18 In other words, the cases that we have so
19 far is where there has been some hint by the Agency
20 that it wants to reconsider, that something has come
21 to its attention, so there's some point to delaying.
22 Where is there any hint here that the Commission is
23 likely to come to grips with what these questions have
24 suggested is troubling?

25 THE COURT: You understand Judge Rogers is

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1 dubious even in delaying long enough to give you a
2 stay. She thinks your position is so relatively weak
3 that we should go right to the merits.

4 THE COURT: Actually, I'm only asking you
5 a question.

6 (Laughter.)

7 THE COURT: She's also much more polite
8 than Judge Silberman and I are.

9 (Laughter.)

10 MR. DOROSHOW: Well, I guess there are a
11 few responses to that question. First of all, all of
12 the issues are, of course, are on the table on
13 reconsideration and in fact, the Petitioners have
14 filed comments and have weighed in on every issue.

15 THE COURT: I mean in some of the other
16 cases, the Commission has suggested well, there are
17 new members on the Commission, they're re-examining
18 things, all that sort of thing. Is that a factor
19 here?

20 MR. DOROSHOW: I can't speak to that.

21 THE COURT: All right, so there's no hint
22 in that regard.

23 MR. DOROSHOW: I honestly can't speak to
24 that either way.

25 THE COURT: What I'm getting at is there

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1 is so much water over the dam, are we just going to be
2 back here a year from now basically faced with the
3 same record?

4 THE COURT: Or if we wallop you, I mean,
5 another way to ask the same question, if we wallop you
6 with a stay, it's very clear what we're suggesting.
7 Are you still going to be intransigent? Another way
8 to ask what Judge Rogers is saying is the Commission
9 still going to stonewall? And if so, then maybe what
10 she's suggesting makes sense. Let's put it to rest
11 now.

12 THE COURT: Another way of putting the
13 question is in the first opinion I thought at any
14 rate, when I read it that the Court indicated some
15 substantial concern about starting with 35 cents. But
16 the Commission's second order suggests to me at any
17 rate the way I'm reading it and maybe I'm incorrect,
18 that it viewed the Court's first opinion to say look,
19 there are some differences in costs here, so address
20 those and the Commission says fine, we'll address
21 them. And that was the extent of the Commission's
22 view of the Court's first opinion.

23 MR. DOROSHOW: I think the Commission went
24 further than that. I think we started from first
25 principles. We started with the question of why use

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1 a market approach? Why use a market proxy? And we
2 went to great lengths to explain the reasons for doing
3 that.

4 THE COURT: That should worry you having
5 gone to great lengths if you haven't persuaded
6 anybody.

7 THE COURT: Forgive me, counsel, but it
8 strikes me that the Commission took the Sir Edmund
9 Hillary approach, do you remember when he was asked
10 why he climbed Mount Everest and he said because it
11 was there. It looks like the Commission said we took
12 35 cents because it was there.

13 MR. DOROSHOW: I disagree with that, Your
14 Honor. In fact, we can --

15 THE COURT: Well, your time is up. Finish
16 your last sentence.

17 MR. DOROSHOW: Okay, Your Honor, if there
18 are no further questions I'll give my time over to Mr.
19 Kellogg.

20 ORAL ARGUMENT OF MICHAEL KELLOGG, ESQ.

21 ON BEHALF OF INTERVENORS

22 Chief Judge Edwards, and may it please the
23 Court --

24 THE COURT: Mr. Kellogg, I've seen you
25 come from the floor before successfully.

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1 THE COURT: You're in the basement now.

2 (Laughter.)

3 MR. KELLOGG: I'm moving up, I hope. Let
4 me start by assuring the Court that the Commission did
5 address directly and exactly the Court's concern of
6 why start with the 35 cent rate.

7 THE COURT: We understand they attempted
8 to address -- the question being raised is have they
9 done it in any way that makes any sense that's
10 rational?

11 MR. KELLOGG: Absolutely. Absolutely.
12 Please let me explain. Paragraph 42 of the opinion,
13 Joint Appendix 1436, they explained that the reason
14 they started with the local coin rate and then did a
15 voided cost was to insure that each type of payphone
16 call makes the same contribution to joints and common
17 costs so that the payphone owner is indifferent to
18 whether it's a local coin call or a dial around call.

19 THE COURT: But look at that very page.
20 They say "our general approach is to start with the
21 market rate for local coin service, 35 cents."

22 MR. KELLOGG: And they explain what,
23 because they want to have each type of call --

24 THE COURT: And subtract costs directly
25 attributable to coin calls and add costs specific to

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1 access code and subscriber 800 calls.

2 THE COURT: They're not the same markets.

3 MR. KELLOGG: No, the point is --

4 THE COURT: You can't say it and make it
5 so.

6 MR. KELLOGG: The point is -- it's a
7 fundamental question that the other side has never
8 answered and I would love to hear Mr. Morris' answer
9 when he stands up in rebuttal. Why should a business
10 caller using a credit card pay less, make less of a
11 contribution to the joint and common costs of that
12 payphone than some guy standing on a street corner
13 fishing coins out of his pocket.

14 THE COURT: Look, Mr. Kellogg, the problem
15 is it's the FCC that says the markets are essentially
16 the same --

17 MR. KELLOGG: No.

18 THE COURT: Yes. You just heard FCC
19 counsel get up here and say exactly what the Agency
20 has said, that's the way the three of us have read it
21 and you can't make that go away. That is the starting
22 premise, as they call first principles. That first
23 principle makes no sense and it has not been justified
24 in this case.

25 MR. KELLOGG: What I understand it to mean

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1 and I think the key passage is right there in 42 where
2 they talk about the same contribution to joint and
3 common costs --

4 THE COURT: In other words, your view now,
5 your view now is that this has got nothing to do with
6 markets whatsoever.

7 MR. KELLOGG: No, they are very similar
8 markets. There's no question about that.

9 THE COURT: No, no, no. But the rationale
10 you're making has got nothing to do with the market
11 rationale, right?

12 MR. KELLOGG: Oh, it does, absolutely.
13 It's quite a complicated thing, but do let me explain.

14 THE COURT: Go ahead.

15 MR. KELLOGG: They really made two
16 methodological decisions. The first one and the
17 critical step was they wanted to use a market based
18 not a cost based approach.

19 Now I understood the premise of a lot of
20 the questions here to be assuming that the only
21 legitimate regulatory approach is sort of a bottoms up
22 cost base. And that's not what Congress said in the
23 statute. They said fair compensation.

24 THE COURT: I think your brief was, if may
25 say so, elegantly and brilliantly put to suggest that

1 the only alternatives were cost based or the present
2 rule. Do you really analytically think that's true?

3 MR. KELLOGG: You know, the other side
4 never came up with a single alternative market based
5 proposal.

6 THE COURT: You know that's an interesting
7 point of which I'd like to ask them about that because
8 it may well be that -- but you see they don't have to.
9 If they say look, we would have liked cost base, but
10 what the FCC has done is unreasonable. Is it their --
11 as a matter of administrative law, is it their
12 obligation to come up with some other third position
13 which might be thought by the Court to be reasonable?

14 MR. KELLOGG: I think it is if the first
15 step in the Commission's analysis --

16 THE COURT: Not as a matter of rule, not
17 if their analysis -- you see, it's interesting.
18 You're trying to -- what you start out by saying,
19 you're right, what they meant to say. That doesn't
20 cut it. Because the FCC counsel just stood here who
21 represents the Agency doesn't say what you say. Now
22 you may be right. You have a way you can do it, but
23 you better get the Agency to embrace that view and to
24 'fess up if what you're suggesting is true because
25 that's not the way they've analyzed it.

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1 MR. KELLOGG: It does say it though, right
2 in the order in paragraph 42. I mean it says this way
3 we insure that the payphone provider is indifferent
4 whether it's a coin call or a dial around call.

5 THE COURT: Why all the language in the
6 order that talks about the markets, the markets
7 similarity, converging of costs and markets --

8 MR. KELLOGG: The markets are similar in
9 the sense that there is a large proportion of joint
10 and common costs shared between the two types of
11 costs. We submitted testimony by Professor Jerry
12 Houseman of MIT, a noted economist who said that in a
13 voided cost analysis like this, he's just fine, it's
14 perfectly acceptable economics. Congress itself in
15 the 1996 Act --

16 THE COURT: The voided cost analysis for
17 which part of it?

18 MR. KELLOGG: Starting with the market
19 rate of the coin call and with the offsets of 35
20 cents.

21 THE COURT: The voided cost doesn't get
22 you to 35 cents.

23 MR. KELLOGG: You start from the 35 cents.

24 THE COURT: That's the problem.

25 MR. KELLOGG: No, but he explained why

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1 with a lot of joint and common costs --

2 THE COURT: Go ahead.

3 THE COURT: This has nothing to do with
4 voided costs. Go ahead.

5 MR. KELLOGG: See, if anything, the
6 Commission's approach was highly conservative here.
7 What Professor Houseman explained is when you have a
8 lot of joint and common costs in common, you usually
9 look to demand substitution factors. Like in the
10 airline industry, business travelers pay a lot more
11 than local travelers. In this context, business
12 callers, callers using credit cards are quite willing
13 to pay a lot more for the use of that pay phone.

14 THE COURT: Is the FCC assuming that this
15 is a perfectly competitive market?

16 MR. KELLOGG: The FCC is assuming that it
17 is workably competitive and this Court affirms that.

18 THE COURT: You know I'm about to ask you,
19 are they -- they have said in the first case I thought
20 here again it's not a perfectly competitive market.
21 If that's the case you've got real problems in
22 suggesting that just willy-nilly go off into costs and
23 rates converge. And you know that.

24 MR. KELLOGG: What they said is two
25 things. They said it's not yet competitive because --

1 THE COURT: It's far from it is our
2 understanding the first time around and nothing
3 changed. It's far from a perfectly competitive
4 market.

5 MR. KELLOGG: But that is not correct,
6 Judge Edwards, because the first time --

7 THE COURT: It's a perfectly competitive
8 market?

9 MR. KELLOGG: You affirmed the
10 Commission's conclusion that they could deregulate the
11 local coin rate and the competitive forces would keep
12 that at competitive levels. Now that means it's a
13 workably competitive market and nobody, not one of the
14 Petitioners has come in and said no, it's not because
15 look at the experience in such and such a state.

16 THE COURT: The FCC itself has said that
17 it is not a perfectly competitive market.

18 MR. KELLOGG: It doesn't have to be
19 perfectly competitive.

20 THE COURT: In order for them to be able
21 to make the argument that they're making resting on
22 the convergence of rates and costs, it becomes real
23 problematic if you don't have something approaching a
24 strongly competitive market.

25 MR. KELLOGG: No, you are buying into

1 their premise that the whole point of a market based
2 approach is to reach a surrogate for cost and that's
3 not what they were doing here. They specifically said
4 we're not doing a cost based approach.

5 Cost based approach would be --

6 THE COURT: Then why are you deducting
7 cost offsets? You're mixing apples and oranges,
8 aren't you?

9 MR. KELLOGG: No, you're not mixing apples
10 and oranges and Professor Houseman has explained why
11 you're not mixing apples and oranges.

12 Congress itself in the 1996 Act mandated
13 an avoided cost analysis in determining rates for
14 resale. You start with the retail rate and you
15 subtract costs.

16 THE COURT: I'm only asking why do you
17 have the cost offsets off the figure if the figure is
18 not designed to reflect costs anyway?

19 MR. KELLOGG: Because the result they're
20 looking for is a market based surrogate, not a cost
21 based surrogate.

22 THE COURT: Do you see my concern about
23 apples and oranges being put together?

24 MR. KELLOGG: No, it's not apples and
25 oranges.

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1 THE COURT: It looked the apples is what
2 we want and the oranges is what the Court wanted so we
3 took the oranges off the apples. Isn't that really
4 the way it looks?

5 MR. KELLOGG: No. I think in economics an
6 avoided cost analysis starting with the market rate
7 and adjusting for costs is perfectly acceptable when
8 you want to reach a market based rate and they explain
9 several good reasons why they wanted a market base,
10 not a cost base rate. For one thing, they want to
11 deregulate this market. They don't want to be
12 involved in yearly rate of return regulation.

13 THE COURT: I think you're absolutely
14 right in making the argument that the FCC doesn't have
15 to go to a cost based system. I think that's right.
16 I think this Court recognized that before.

17 The problem is sort of -- where we are is
18 sort of the half slave, half free and we can't quite
19 figure it out.

20 I also have a sense that it may well be
21 that there is, this is a strange animal here and that
22 there is no pre-existing way of doing this that's
23 going to look exactly right. It involves some new
24 thinking as to how to come up with an answer that will
25 be reasonable that would get by. It may well be that

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1 the 35 cents, it may well be that the argument of the
2 relationship between the coin operated pay phone and
3 the noncoin operated pay phone is so close that you
4 can't hypothetically think about the noncoin operated
5 market. It may well be. But I haven't seen an
6 explanation in the FCC's opinion that explains that.

7 MR. KELLOGG: Well, I think the relation
8 --

9 THE COURT: It doesn't look to me like the
10 FCC's opinion was written with the sophistication of
11 some Intervenor's briefs.

12 MR. KELLOGG: Well, once you -- thank you.
13 Once you get over the first hurdle and say that we
14 want a market based, not a cost based rate, that the
15 statute allows them to choose a market base. After
16 all, it's a critical consideration that you want a
17 payphone in a remote location on a mountain in Alaska
18 to cost more than a payphone downtown because it
19 wouldn't be there otherwise because it costs a lot
20 more to put it there. You want the flexibility of
21 different rates.

22 THE COURT: Maybe, maybe. We don't know
23 that.

24 MR. KELLOGG: That's why -- the FCC can
25 make an expert judgment to that effect.

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1 THE COURT: That's right, they could. Is
2 that the judgment that's made?

3 MR. KELLOGG: They did explain that. They
4 did explain that they want to allow for variations of
5 costs.

6 THE COURT: If they require a lot of money
7 for call, there will be more payphones. I understood
8 that.

9 (Laughter.)

10 MR. KELLOGG: They also, well, in a sense
11 the judgment they're making about the rate is a
12 judgment about the deployment of payphones, the higher
13 the rate, the more payphones, the lower, the less.

14 THE COURT: You wouldn't for a moment
15 stand there and say that any rate is justified and it
16 will produce more pay phones.

17 MR. KELLOGG: But the thing is --

18 THE COURT: I'm not even sure that's true
19 because then people will figure a way to bypass it.

20 MR. KELLOGG: The thing that's really
21 critical here is that the FCC had a number of
22 proposals for market based solutions. We said look,
23 we think you should look at the 0+ commissions that
24 the IXCs are willing to pay. They pay up to a dollar
25 a call for those calls because they make about \$2.50

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1 in revenue on them. So that's why they want them.
2 The reason dial around has increased so much is
3 because they get those for free. They don't have to
4 pay that dollar and they still make their \$2.50.

5 THE COURT: Who is "they"?

6 MR. KELLOGG: We get nothing. The
7 inter-exchange carriers.

8 THE COURT: Gets it for free.

9 MR. KELLOGG: And the LECs --

10 THE COURT: What do you mean gets it for
11 free?

12 MR. KELLOGG: Because the dial around they
13 don't have to pay, they have not, historically, had to
14 pay compensation on those calls. They don't have to
15 pay the contract and commissions.

16 THE COURT: Don't they have any access
17 charges?

18 MR. KELLOGG: The access charge has been
19 removed. That was the whole point of 276. Our
20 payphones used to be subsidized and we didn't get
21 anything for those calls. We've removed all those
22 subsidies over a year ago.

23 Now our payphones are in desperate straits
24 because they're not paying.

25 THE COURT: Your time is up.

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1 MR. KELLOGG: Thank you, Your Honor.

2 THE COURT: We got you. Thank you. Is
3 there any time on rebuttal?

4 CLERK: Mr. Morris has no time. Mr.
5 Kramer has two minutes.

6 THE COURT: What about his question he put
7 to you, you've never come up with any position.
8 You're certainly not taking the position here that the
9 FCC must come up with a based system a la public
10 utilities?

11 REBUTTAL ARGUMENT OF JOHN B. MORRIS, ESQ.

12 ON BEHALF OF PETITIONERS MCI

13 MR. MORRIS: No, Your Honor, we are not
14 suggesting that as a matter of law.

15 THE COURT: And they are certainly
16 entitled to reach towards market rate.

17 MR. MORRIS: They certainly are and I'm
18 hopeful on remand or after a stay that the Agency will
19 be able to do some creative thinking as --

20 THE COURT: Well, what about your position
21 on this?

22 THE COURT: What does that mean? How can
23 they do creative thinking if there's nothing to think
24 about? That's essentially what Mr. Kellogg is saying
25 to you. What are you talking about?

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1 MR. MORRIS: Well, I mean I would suggest
2 that costs have to be an important factor because as
3 we've gone through this exercise now two times, there
4 is not as far as I can tell, a good way to estimate
5 the market --

6 THE COURT: Because there is no square
7 market that we can think of for the dial around
8 services?

9 MR. MORRIS: Absolutely. There is simply
10 no good proxy that we can come up with.

11 THE COURT: If that's true, if that's true
12 and yet in the long run market rate is the right way
13 to go, why isn't their basic approach correct, then?

14 MR. MORRIS: Well, I would suggest that
15 it's --

16 THE COURT: They being the FCC.

17 MR. MORRIS: If the FCC truly wants to
18 have a market approach, then it should reconsider as
19 it was asked to do on the second go around, the caller
20 pays of option, because a caller pays option will get
21 back to as Mr. Kellogg wants, the situation where he's
22 pointing out that businessman on the street should pay
23 the same 35 cents. Well, the problem is is that the
24 FCC, there's no explanation as to why --

25 THE COURT: It's so nice to hear the RBOCs

1 make such a redistribution as to argue.

2 (Laughter.)

3 It's not usually the kind of thing we see
4 from Mr. Kellogg.

5 MR. MORRIS: I mean there are certainly
6 problems with caller pays and issues as to why the FCC
7 may not want to do that, but that would be a market
8 solution that is actually remarkably close to the
9 local coin situation. The person who decides to use
10 the payphone pays for the call.

11 THE COURT: Okay.

12 THE COURT: All I can say as one Judge, I
13 find this thing very confusing and very mystifying and
14 very difficult. It's not an easy question, but I am
15 inclined to have the same view of my colleagues here
16 that the FCC, there may be something here that we
17 don't understand but I think it's because the FCC
18 hasn't tried to explain it.

19 MR. MORRIS: I would say the FCC has not
20 explained it and the only explanation proffered by
21 either Mr. Kellogg or the FCC is paragraph 42 and as
22 Judge Rogers pointed out, that's taken entirely out of
23 context. They start paragraph 42 with a market rate
24 assumption.

25 THE COURT: That's a good point, though.

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1 All right.

2 MR. MORRIS: Thank you.

3 REBUTTAL ARGUMENT OF ALBERT H. KRAMER, ESQ.

4 ON BEHALF OF PETITIONERS, ILLINOIS PUBLIC

5 TELECOMMUNICATIONS ASSOCIATION

6 First of all, Judge Rogers, in response to
7 your question, the FCC does have authority to order a
8 2 up here while the rates remain in effect, to order
9 payment and order a subsequent adjustment. I would
10 cite you to page 572 of the Joint Appendix, footnote
11 4 for Natural Gas (Inaudible) v. FERC, and Public
12 Utilities Commission of California v. FERC, are cited.
13 Indeed, we are waiting just such a true-up on the
14 interim which is still hanging out there --

15 THE COURT: You started off by saying
16 what, they have the authority to do what, I missed
17 you?

18 MR. KRAMER: They have an authority to
19 order a retroactive true-up. Judge Rogers inquired
20 whether they could order this rate and then order a
21 true-up later. And the answer is yes, that authority
22 has been upheld by the Courts.

23 Your Honor, Judge Silberman, you indicated
24 in addressing a stay you have two issues to address
25 the merits and the equities. I would like to speak to

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1 the equities for a moment. You should understand that
2 what is going on here is the carriers have been
3 collecting this money from end users for over a year
4 now and none of that money is going to the payphone
5 providers. So you have a horribly inequitable
6 situation where the carriers are collecting and --

7 THE COURT: Suppose we're inclined to
8 believe that the 35 cents starting point is -- we're
9 inclined to believe it's unreasonable. And therefore
10 the Petitioners are likely to prevail on the merits.
11 What is the nature of the stay that should be granted
12 in your view?

13 MR. KRAMER: Your Honor, in my view what
14 the Court should do in that case is that the Court
15 should order the rate to stay in effect, pending a
16 true-up as is authorized under the cases I just cited.
17 And that there would have to be some true-up at the
18 point, but in the meantime since the Court does not
19 have rate making authority, the Court should allow a
20 rate to stay in effect. It's fundamental that there
21 should be a rate. That is what Congress mandated.

22 THE COURT: Well, what was the situation
23 there was no rate at all during the period of time
24 after this -- the rule was vacated, right?

25 MR. KRAMER: There has been no rate and

1 that's been the problem, Your Honor.

2 THE COURT: No, I mean so you lived under
3 that circumstance because the FCC's rule was vacated
4 by this Court.

5 MR. KRAMER: If you could call it living,
6 I suppose you did.

7 (Laughter.)

8 We did. But that isn't -- there is an
9 enormous catch crunch they are not living and that's
10 the reason why we're so concerned about a stay and in
11 calling to the Court's attention there is the
12 authority to order a true-up here.

13 Remember, we're talking about something in
14 1995, we're not just talking about the legislation
15 here. In 1995, this Court had to reverse the FCC
16 because it failed to order dial around compensation on
17 1-800 calls in the Florida Pay Telephone case, so
18 we're looking at a long history here. And I would
19 again emphasize that -- although I think the Court has
20 the point that there is no requirement here that this
21 be a cost based rate --

22 THE COURT: I think you ought to focus on
23 the stay question now.

24 MR. KRAMER: All right. Well, Your Honor
25 --

1 THE COURT: And do it in one more
2 sentence, because you're done, your time is up.

3 MR. KRAMER: Thank you, Your Honor, may I
4 just indulge for one moment to address one point that
5 Mr. Kellogg addressed and I'd like to try to clear up
6 something Judge Silberman said.

7 Judge Silberman, you were concerned about
8 this seeming apples and oranges comparison. The
9 reason for the apples and oranges comparison is
10 because if you begin from the premise that Mr. Kellogg
11 correctly begins from, that the FCC's objective here
12 was to say in a market as close as they could get to
13 a market here, all costs should bear a fair share of
14 joint and common costs. Having begun from the apple,
15 the FCC then had to say but we're called upon here to
16 engage in an exercise where we have to take an orange,
17 namely a voided cost to make sure that we're meeting
18 that standard. So when you're looking, you may be
19 looking at an apples and oranges analysis, but it's
20 because you had to have a basket of fruit to make it
21 come out correctly, not because the FCC was comparing
22 two wrong things.

23 THE COURT: I understand the FCC's
24 position.

25 MR. KRAMER: Thank you.

1 THE COURT: Okay, thank you. The case is
2 submitted.

3 (Whereupon, oral argument was concluded.)
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MATTER: MCI TELECOMMUNICATIONS CORPORATION,
Petitioner,
v.

FEDERAL COMMUNICATIONS COMMISSION
AND UNITED STATES OF AMERICA,
Respondent.

DATE: MAY 7, 1998

I hereby certify that the attached transcription of pages 1 to 62 inclusive are to the best of my belief and ability a true, accurate, and complete record of the proceedings as recorded on tape provided to us by the agency.

Francesca Zoh 05/12/98